ICRA NEPAL

Deurali Janta Pharmaceuticals Private Limited: Ratings upgraded to [ICRANP] LA-/A2+ and removed from 'Issuer not cooperating' category

December 11, 2023

Summary of rating action

Instrument*(Amount in NPR million)	Previous rated limit	Current rated limit	Rating Action
Fund based; long term limits	277.2	143.1	[ICRANP] LA-; upgraded from [ICRANP] LBBB+ and removed from 'Issuer not cooperating' category
Fund based; short term limits	372.5	712.5	[ICRANP] A2+; upgraded from [ICRANP] A2 and removed from 'Issuer not cooperating' category
Non-fund based; short term limits	170.0	320.0	
Total	**819.7**	**1,175.6**	

** Instrument details are provided in Annexure-1.*

Rating action

ICRA Nepal has upgraded the long-term rating assigned to Deurali Janta Pharmaceuticals Private Limited (DJPL or the company) from [ICRANP] LBBB+ (pronounced ICRA NP L Triple B Plus) to [ICRANP] LA- (pronounced ICRA NP L A minus) and upgraded the short-term rating from [ICRANP] A2 (pronounced ICRA NP A Two) to [ICRANP] A2+ (pronounced ICRA NP A two plus) to the company's bank loan limits. The ratings have been removed from 'Issuer not cooperating' category.

Rationale

The rating action factors in DJPL's heathy operational and financial performance in the recent period, characterised by sound year on year revenue growth on strong operating margins and a low gearing, which has resulted in comfortable debt coverage ratios amid low debt utilizations. This along with comfortable liquidity position with adequate headroom in drawing power also remain positive. The ratings continue to take comfort from established track record of over three decades of operation, its experienced promoters and management team, along with its strong brand recognition in the domestic pharmaceutical industry. DJPL's wide therapeutic coverage across multiple product lines and its established supply chain with over 200 distributors, continue to remain positive for the future revenue growth and its sustainability.

The ratings, however, are constrained by DJPL's rising working capital cycle amid increasing debtor days which are largely unsecured. Nonetheless, company's healthy profitability, controlled dividend outflow and resulting profit accruals in recent years supports the current liquidity profile. The rating concern also arise from the fragmented and hence intensely competitive domestic pharmaceutical arena given the presence of multiple established players, recent entry of new players and low duty protection against the cheaper imports, which could challenge the future scalability and profitability of the company. The company remains dependent on imports for almost its entire raw material requirement, which exposes it to supply chain disruption risks. The pharmaceutical sector also remains vulnerable to the regulatory risk, which remains a key rating sensitivity.

Going forward, the company's working capital cycle and liquidity management will remain key rating monitorable.

Key rating drivers

Credit strengths

Established track record of the company with experienced promoters – Incorporated in 1991, DJPL has an established track record of over three decades and enjoys a good brand recall in the domestic market. The major promoters of the company are reputed in the domestic business arena and have a long experience in the pharmaceutical industry.

Strong financial profile characterized by healthy profitability and comfortable debt coverage indicators – DJPL is one of the leading pharmaceutical sector players in the domestic pharmaceutical manufacturing. The company witnessed a healthy revenue CAGR[1] of ~16% between FY2020 and FY2023 with a stable operating margin, which indicates DJPL's strong market positioning. Although, revenue declined in FY2020 (y-o-y growth of -22%) amid supply chain disruptions and lockdown during the pandemic and management's expansion project in the interim, the growth has rebounded from FY2021. This has also helped the company maintain a good financial profile. Good profitability, adequate cash generation and healthy retention of profit accruals has helped the company maintain low gearing ratio and comfortable coverage metrics. Despite the gradual uptick in working capital intensity, the company's current liquidity position also remain comfortable.

Established supply chain, diversified product portfolio and customer base – DJPL has an established and tested distribution network comprising over 200 distributors. The traction developed by DJPL with its distributors and other stakeholders in the local market remains a positive for the incremental growth and its sustainability. DJPL's customer base is fairly diversified with its top ten distributors accounting for ~22% of total FY2023 revenue. In addition, the company has also been expanding its product range across different therapeutic segments over the years utilizing internal accruals. The company's factory expansion in Terai belt of Nepal also augurs well for the portfolio and revenue expansion.

Credit challenges

Fragmented market, low entry barriers and competition from cheaper imports – The domestic pharmaceutical industry remains highly competitive and fragmented with multiple active players. The industry is also witnessing fresh capacity creation in recent years, which is likely to intensify the competition, exert pricing pressure and moderate margins of all the players. At the same time, low import barriers on pharmaceutical products also expose the domestic players to competition from cheaper imports. All these factors remain challenges to the scalability and long-term profitability of the domestic players.

Rising working capital intensity due to increased receivables – DJPL witnessed increase in working capital intensity in FY2023 (NWC/OI[2] of ~39% in FY2023 vs.~33% in FY2022). This has been contributed by the increase in debtor days in FY2023 (~121 days as on mid-July 2023 vs. ~95 days as on mid-July 2022). The competitive pressure and tightened liquidity in the Nepalese banking sector contributed by stringent working capital guidelines introduced by the central bank have contributed to the elevated debtor level, thus creating pressure on the working capital intensity. Moreover, the debtors remain unsecure and any write-offs from such debtors or delays in recovery could affect incremental profitability. A sustained rise in working capital intensity coupled with margin moderation and/or elevated dividend outflow could necessitate increased reliance on bank loan financing for working capital management, impacting its profitability and liquidity profile. However, adequate headroom in the company's current working capital drawing power remains a positive in absorbing any near-term liquidity shocks.

Dependence on import for raw materials and regulatory risks – DJPL is completely dependent on imports for all its raw materials like active pharmaceutical ingredients (API), excipients, packing materials, etc., which exposes the company to supply chain disruption risks. The sector also remains vulnerable to the regulatory risks. Therefore, issues like price ceiling on certain products or promotion of generic medicines over the branded ones could affect the company's revenues and profitability.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
[Corporate Credit Rating Methodology]

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[1] Compound annual growth rate
[2] Net Working Capital/ Operating Income

Links to the previous rating rationale(s):

[Deurali Janta Pharmaceuticals Private Limited_Ratings placed on Issuer not Cooperating category August 2023]

[Rationale_Deurali Janta Pharmaceuticals Private Limited_BLR Surveillance January 2022]

About the company

Incorporated in 1991, Deurali Janta Pharmaceuticals Private Limited (DJPL) is among the oldest and established players in the business of pharmaceuticals molecules formulation and therapeutic drugs production. It produces a wide range of general and specialised medications for cardiovascular, diabetic, gynaecology and childcare, gastrologic and hepatology, dermatology ailments, among others. DJPL currently produces over 250 products across multiple categories.

As of mid-July 2023, DJPL's stake is owned mainly by Mr. Hari Bhakta Sharma, Executive Director, and Chairperson (~71%) with the remaining stake held by his family members and associates.

Key financial indicators

	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Provisional)
Operating income-OI (NPR million)	1,534.5	1,196.4	1,469.1	1,705.5	1,863.5
OPBDITA/OI (%)	26.4%	17.1%	19.6%	19.0%	21.7%
Total debt/Tangible net-worth-TNW (times)	0.5	0.4	0.4	0.3	0.3
Total outside liabilities/ TNW (times)	1.7	0.7	0.7	0.6	0.5
Total debt/OPBDITA (times)	0.8	1.9	1.4	1.3	0.9
Interest coverage (times)	11.8	5.5	15.3	7.4	7.3
DSCR (times)	9.7	5.0	13.1	3.2	3.2
Current ratio (times)	0.8	1.4	1.2	1.5	1.6
NWC/OI	41%	37%	29%	33%	39%

Source: Company data

Annexure-1: Instrument Details

Instrument	Previous Rated Amount (NPR million)	Current Rated Amount (NPR million)	Rating action
Fund based; long term limits (A)	**277.2**	**143.1**	[ICRANP] LA-; upgraded from [ICRANP] LBBB+ and removed from 'Issuer not cooperating' category
Term loan	277.2	143.1	
Fund based; short term limits (B)	**372.5**	**712.5**	[ICRANP] A2+; upgraded from [ICRANP] A2 and removed from 'Issuer not cooperating' category
Cash credit/Overdraft/Working capital loan/TR loan	372.5	282.5	
Proposed working capital loan/TR loan	-	430.0	
Non-fund based; short term limits (C)	**170.0**	**320.0**	
Letter of Credit/ Bank guarantee	170.0	220.0	
Proposed Letter of Credit/ Bank guarantee	-	100.0	
Total (A+B+C)	**819.7**	**1,175.6**	

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About ICRA Nepal Limited:

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